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Supreme Court of the United States

MANHATTAN PROPERTIES, INC.,

Petitioner,

vs.

505.

IRVING TRUST COMPANY, as Trustee in Bankruptcy of Oliver A. Olson & Co., Inc.,

Respondent.

SAMUEL R. BROWN, ALMIRA B. MALLARD, ALFRED MALLARD and HUGH MALLARD,

Petitioners,

vs.

IRVING TRUST COMPANY, as Trustee in Bankruptcy of United Cigar Stores Company of America, a New Jersey corporation, 506.

Respondent.

BRIEF OF AMICUS CURIAE ON BEHALF OF THE COTTON TEXTILE MERCHANTS ASSOCIATION OF NEW YORK, WHOSE MEMBERS, AS GENERAL MERCHANDISE CREDITORS, HAVE NUMEROUS CLAIMS IN BANKRUPTCY PROCEEDINGS.

Foreword.

This brief is submitted on behalf of the members of the Cotton Textile Merchants Association of New York, whose business constitutes the major portion of the primary distribution of cotton goods throughout the whole country. The members of the Association, as general merchandise creditors, have on file many proofs of claim in numerous bankruptcy proceedings now pending throughout the country and in the ordinary course of events will file many more in the future.

The Association has believed it necessary for the protection of the interests of its members as such general merchandise creditors to appear in these proceedings on certiorari, if the Court will permit, and to put forward the grounds which it believes exist for the continuation of the rule laid down by the United States Circuit Court of Appeals for the Second Circuit in *In re Roth & Appel*, 181 Fed. 67.

We believe the submission of this brief is apt in the light of the fact that briefs are being submitted in behalf of many landlords with a view to obtaining a reversal of the rule laid down in *In re Roth & Appel, supra,* and because upon the questions involved in these proceedings, it appears that the interests of landlords as a class are definitely opposed to the interests of general merchandise creditors.

POINT I.

The rule landlords seek to change.

The rule laid down in *In re Roth & Appel, supra,* is simply that rent accruing after the filing of the petition in bankruptcy is not provable even though the lease contain a covenant to pay it and even where the lessee had in addition covenanted to indemnify the lessor *seriatim* in case of re-entry for breach of condition.

It is not our purpose in this brief to attempt a thorough analysis of the decisions for that will doubtless be presented to the Court by the eminent counsel for the parties in the above entitled proceedings. Furthermore, the whole subject, together with the decisions bearing upon it, has been most ably presented by Wolfgang S. Schwabacher, Esq., and Sidney C. Weinstein, Esq., both of the New York Bar, in their article entitled, "Rent Claims in Bankruptcy," which appeared in the Columbia Law Review (Vol. XXXIII,

No. 2, Feb., 1933). The decision of the Court, however, in these proceedings will have a very far-reaching effect upon the rights of general merchandise creditors. If the rule now in force should be changed so as to permit landlords' claims for future rent—or indemnity—to be allowed, it is plain that in many, if not in most, bankruptcies of firms of large business, the claims of landlords for future rent might well equal, if not heavily exceed, the sum total of all other claims; in this way reducing, in many cases doubtless almost to the vanishing point, that portion of the bankrupt estate available for dividends to general merchandise creditors. Landlords are already in a preferred position in bankruptcy cases, since at least they get their property back. To adopt a rule which in addition to this would enable the landlords to receive—as would result in so many bankruptcy cases—the lion's share of the estate would, we submit, work such a serious injustice to the general merchandise creditors as to render the bankruptcy law almost of no service whatever to them, even though they are, as a rule, the ones who have given life to the bankrupt's business and whose contribution has made the bankrupt's business possible.

POINT II.

Claims of general merchandise creditors are based on business transactions undertaken in reliance on financial statements which do not include rent to accrue in the future as among the "liabilities".

To change the rule so as to allow claims for future rent would be tantamount to approving a fraud upon the general merchandise creditors. They enter upon the business transactions which are the bases of claims in bankruptcy in reliance upon statements by the bankrupts of their assets and liabilities. The Court is doubtless aware

that such statements do not include under the heading of "liabilities" rent to accrue in the future; and this has been proper in the light of the rule now existing. Business has been and is being done throughout the country in reliance upon such statements and with no knowledge on the part of the general merchandise creditors of the existence of any such overwhelming liability as might be ascertained from an examination of the bankrupts' leases. To upset the rule would therefore be to upset the general course of dealing throughout the country and bring into business transactions generally a further and most undesirable element of doubt and uncertainty.

In terms of abstract justice—whatever that may mean—is there any basis for the landlord to be still further preferred over the general merchandise creditor? The general creditors, whose goods have made the bankrupt's business, take the bitter with the sweet through the cycles of prosperity and depression. Why should a rule be adopted which would place the landlord in a still more preferred position? In this connection the Court will doubtless take judicial notice of the fact that before a lease is made very much more critical consideration is given to protection of the landlord's rights than to the tenant's. It might even be said that we have scarcely ever seen a lease which contains a provision binding the landlord to do anything except to put the tenant into possession. The great bulk of leases is filled with obligations incurred by the tenant to which he generally must accede if he is to occupy the property. And some of these provisions are amazing in their onerousness, particularly the provisions so frequently inserted which bind the tenant to pay for five, ten, fifteen, twenty-one years, or even more—in case the tenant gets into finacial difficulties—the difference between the rent reserved and the rental value. These provisions are obviously of no avail against a tenant corporation which becomes bankrupt, but are really inserted in the hope of securing

for the landlord the lion's share of the bankrupt estate to the detriment of all other creditors who deal with the bankrupt upon the faith of its financial statement, which invariably excludes any such contingent liability.

POINT III.

The estimation of damages for breach of covenants to pay rent through future years is generally too speculative to permit of proof with reasonable accuracy.

The difficulty of approximating the actual loss to the landlord over the balance of a term of years is a further reason for adhering to the existing rule; for example, suppose the bankruptcy of a tenant took place in 1928 and the landlord attempted to prove as his damage the difference between the rent reserved in the lease and the rental value of the property during the balance of the term. The proof would be chiefly out of the mouths of experts and real estate brokers, etc. The witnesses who in 1928 would have foreseen the conditions realized in the following five years would have been few indeed. The conclusion would have been reached, in all probability, that no damage was shown: On the other hand, similar proceedings in relation to a bankruptcy of a tenant a few years later would doubtless have adduced testimony and evidence of great loss over the following years. The history of the country shows however so many cycles of prosperity and depression that it is impractical to adopt the estimates of such witnesses as to the demand for real estate five or six years later and, of course, many leases extend for many times such a period. It may therefore well be concluded that the loss a landlord may suffer is so contingent, so uncertain—the years may actually show him a profit—as to render any attempt to fix it too speculative to be indulged in.

POINT IV.

The local law is controlling as to the effect to be given to instruments conveying interests in real property.

To change the rule as urged in behalf of the landlord would be to run counter to the law in many states: in New York, for instance, the rule has been laid down by the Court of Appeals that no cause of action for future rent, or for damages for the breach of a tenant's covenant to pay the difference between the rent reserved and the rental value, accrues until that difference has been ascertained, which can only be at the ends of the various periods provided in the lease as they are reached, or at the end of the term.

McCready v. *Lindenborn*, 172 N. Y. 400.

In this case the Court of Appeals said (at p. 408):

> "We do not sustain the theory upon which the majority of the learned judges of the Appellate Division proceeded to judgment, to wit, that an action will lie for the breach of the lease as an entirety and the recovery of all the damages in a single action brought before the expiration of the term. The breach of an agreement to pay money in installments is not a breach of the entire contract and will not permit a recovery of all the damages in advance."

This decision was discussed by the Court of Appeals with approval in:

Hermitage v. *Levine*, 248 N. Y. 333.

In this case the facts were that the plaintiff had leased to the defendant a seven-story building for a term of 21

years ending in October, 1945, at a rent of $72,000 per year *"payable monthly in advance"*. The defendant went into possession, paid the rent for only a few months and was then dispossessed December 31, 1924.

The lease contained the following provision:

> "In case the tenant shall be dispossessed or ejected, or shall remove from or abandon the demised premises after a demand for the rent or the service of a notice as provided by section 1410 of the Civil Practice Act, or after the commencement of dispossess proceedings, or for any other reason, the landlord may re-enter the said premises by force or process of law or otherwise, and relet the same as agent for the tenant, and the tenant shall remain liable for all damages which the landlord may sustain by any such breach of this agreement, or through such entry or reletting."

The landlord made diligent effort to relet and, by August 1, 1926, had relet the entire building to different tenants, but for varying terms, none of which equalled the 21 years. In March, 1926, the landlord brought this action "to recover the damages suffered by the landlord through the deficiency of rents computed to that time" (p. 336).

The Court said:

> "The principal question is whether the action is premature" (p. 336).
>
> "Is there to be a single cause of action in which all the damage will be computed down to October, 1945, or are there to be monthly causes of action to recover successive deficits, though conceivably new leases made when the present ones are over will make the net result a surplus?" (p. 337).
>
> "No doubt, a damage clause can be drawn in

such a way as to make a tenant responsible for monthly deficits after the re-entry of his landlord, and this without charging the landlord with a duty to account for a surplus in other seasons. Such a clause will be found in *McCready* v. *Lindenborn* (172 N. Y. 400), where the lease was to the effect that the tenant would pay the difference in rent 'in equal monthly payments as the amount of such difference shall from time to time be ascertained'. * * * None the less, in the absence of a provision that points with reasonable clearness to a different construction, a liability for damages resulting from a reletting is single and entire, not multiple and several. The deficiency is to be ascertained when the term is at an end (*Harding* v. *Austin*, 93 App. Div. 564 [per Willard Bartlett, *J.*]; *Halpern* v. *Manhattan Ave. Theatre Corp.*, 173 App. Div. 610, 220 N. Y. 655; *Darmstadt* v. *Knickerbocker C. & E. S. Co.*, 104 Misc. Rep. 547, App. Term, per Lehman, *J.*; 188 App. Div. 129). The tenant when ejected ceases to be a tenant. What he covenants to pay is the damage, not the rent. To hold him for monthly deficits is to charge him with the obligations of a tenant without any of the privileges. He must pay in the lean months, without recouping in the fat ones. He must do this, though it may turn out in the end that there has been a gain and not a loss. A liability so heavy may not rest upon uncertain inference."

These decisions show, then, that no cause of action exists for the deficiency until the lease itself, or the period specified in it, has come to an end. In *McCready* v. *Lindenborn* (*supra*) the deficiency could be determined at the end of each month. Then, and only then,—*if* there was a deficiency—the right of action arose; but only for that month's deficiency. In *Hermitage* v. *Levine* (*supra*) the

right of action did not arise until the whole remaining nineteen years had elapsed, and had shown a deficiency. These decisions are in accord as holding that there is no action for estimated damages through the coming years, and they are the law in New York. It would therefore seem anomalous to adopt a rule in bankruptcy which declared that a cause of action existed in favor of one citizen of the State of New York, for instance, against another, when the highest Court of that State has interpreted the law of that State as not conferring any such cause of action. How therefore could a landlord's claim for damages, as for the breach of the lease as an entirety, be allowed in bankruptcy when the Courts of the State have ruled that he has no such cause of action? Indeed, the decisions of this Court would seem to forbid the allowance of a claim in bankruptcy based upon a state of facts which the state courts hold confers no cause of action, particularly where the construction of an instrument conveying an interest in real estate, etc., is concerned; and, a lease for more than three years is an interest in real property in the State of New York (N. Y. Real Property Law, §§2, 240, 290). The law was stated by this Court in

United States v. *Fox*, 94 U. S. 315

> "And it is an established principle of law, everywhere recognized, arising from the necessity of the case, that the disposition of immovable property, whether by deed, descent, or any other mode, is exclusively subject to the government within whose jurisdiction the property is situated" (p. 320).

Again, in *DeVaughn et al.* v. *Hutchinson et al.*, 165 U. S. 566, 17 Sup. Ct. Rep. 461, this Court declared the rule as follows:

> "It is a principle firmly established that to the

> law of the state in which the land is situated we must look for the rules which govern its descent, alienation, and transfer, *and for the effect* and construction *of* wills and other *conveyances.*" Citing cases (p. 462). (Italics ours.)

In the absence therefore of legislative enactment, it would appear to be contrary both to the decisions of this Court and to the provisions of the judiciary act (declaring that the laws of the several states, except when the constitution, treaties, or statutes of the United States otherwise require or provide, are to be regarded as rules of decision in trials at common law in the Courts of the United States in cases where they apply) for the Federal Courts to adopt a construction of instruments conveying an interest in real property contrary to that adopted by the Courts of the several states.

While doubtless the New York doctrine, as defined in the decisions of the Court of Appeals referred to above, has not been adopted by all other states, still if any modification of the rule laid down in *In re Roth & Appel, supra,* should be deemed advisable, it is submitted that such modification should only be applicable in the districts where it would be in conformity with the state law.

Conclusion.

As stated in the opinion of the Court below in the above-entitled proceedings:

> "The law, as we now understand it, is therefore that a contingent claim may in general be proved, provided its liquidation does not involve too speculative considerations, confessedly a variable standard."

Therefore, if any modification of the rule should seem advisable, we submit that the allowance of a landlord's claim—for rent, or indemnity, accruing after the filing of the petition—should be limited to proof of damage accruing during the 6-months period allowed for the filing of claims: that is, to proof of the difference in the rent reserved and the rent collected during the 6-months period; or, in any event, to that damage accruing within some reasonable time after adjudication, so that proof of loss with a reasonable approximation to accuracy may be ascertained,—subject always, of course, to the existence of the cause of action, which is the basis of the claim, being recognized by the local State law.

Dated: New York, December 8, 1933.

Respectfully submitted,

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